



REPORT OF THE AUDITOR-GENERAL TO THE NORTH WEST PROVINCIAL LEGISLATURE AND THE COUNCIL OF THE NALEDI LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Naledi Local Municipality set out on pages XX to XX, which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, and cash flow statement and the statement of comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP), the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2013 (Act No. 2 of 2013) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Naledi Local Municipality as at 30 June 2014, and its financial performance and



cash flows for the year then ended in accordance with the SA Standards of GRAP and the requirements of the MFMA and the DoRA.

Emphasis of matters

7. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

8. As disclosed in note 34 to the financial statements, the corresponding figures for the year ending 30 June 2013 have been restated as a result of errors discovered during the year ending 30 June 2014 in the financial statements of the Naledi Local Municipality at, and for the year ended, 30 June 2013.

Unauthorised, irregular and fruitless and wasteful expenditure

9. As disclosed in note 35.1 to the financial statements, unauthorised expenditure of R54 322 626 was incurred in the current year and unauthorised expenditure in respect of prior years of R149 642 545 has been dealt with in accordance with section 32 of the MFMA

10. As disclosed in note 35.2 to the financial statements, fruitless and wasteful expenditure of R13 957 947 was incurred in the current year and fruitless and wasteful expenditure in respect of prior years of R687 638 has not yet been dealt with in accordance with section 32 of the MFMA.

11. As disclosed in note 35.3 to the financial statements, irregular expenditure of R27 112 751 was incurred in the current year and irregular expenditure from prior years of R124 181 627 has not yet been dealt with in accordance with section 32 of the MFMA

Material losses and impairments

12. As disclosed in note 23 to the financial statements, impairments of R40 924 920 (2013: R49 704 596) were incurred as a result of significant impairment of debtors.

13. As disclosed in note 27 to the financial statements, material distribution losses of R14 675 308 (2013: R14 870 779) and R5 091 482 (2013: R4 928 336) respectively were incurred as a result of electricity and water losses.

Going concern

14. As disclosed in note 45 to the financial statements a material uncertainty exists that may cast doubt on the entity's ability to continue as a going concern.

Additional matters

15. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unaudited disclosure notes

16. In terms of section 125(2) (e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

Unaudited supplementary schedules

17. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.



REPORT ON OTHER LEGAL AND REGULARITY REQUIREMENTS

18. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for the selected development objectives presented in the annual performance report, non-compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

19. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development objectives presented in the annual performance report of the municipality for the year ended 30 June 2014:

- Development objective X: Provision of access to roads on pages XX to XX
- Development objective X: Provision of water and sanitation to communities on pages XX to XX
- Development objective X: To provide electricity on pages XX to XX
- Development objective X: Provision and monitoring of municipal projects on pages XX to XX
- Development objective X: Provision of access to basic refuse removal services on pages XX to XX

20. I evaluated the reported performance information against the overall criteria of usefulness and reliability.

21. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development objectives. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for managing programme performance information (FMPPI).

22. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

23. The material findings in respect of the selected development objectives are as follows:

Development objectives X: Provision of access to roads

Usefulness of reported performance information

24. The FMPPI requires that indicators be well defined and verifiable and targets be specific, measurable and time bound:

- We could not measure the required performance for 45% of the targets.
- A total of 36% of the indicators were not well defined.
- A total of 36% of the indicators were not verifiable.

This was because management did not adhere to the requirements of the FMPPI due to a lack of proper systems and processes.

Reliability of reported performance information

25. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual



achievements against planned objectives, indicators and targets. The reported performance information was not valid, accurate and complete when compared to the source information or evidence provided. This was due to a lack of standard operating procedures or documented system descriptions for the accurate recording of actual achievements and technical indicator descriptions for the accurate measurement, recording and monitoring of performance.

Development objectives X: Provision of water and sanitation to communities

Usefulness of reported performance information

26. The FMPPI requires that indicators be well defined and verifiable and targets be specific, measureable and time bound:

- We could not measure the required performance for 33% of the targets
- A total of 33% of the indicators were not verifiable.
- A total of 33% of the indicators were not well defined.

This was because management did not adhere to the requirements of the FMPPI due to a lack of proper systems and processes.

Reliability of reported performance information

27. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

Development objectives X: To provide electricity

Usefulness of reported performance information

28. The FMPPI requires that indicators be well defined and verifiable and targets be specific, measureable and time bound:

- We could not measure the required performance for 44% of the targets
- A total of 22% of the targets were not specific.
- A total of 44% of the indicators were not verifiable.
- A total of 44% of the indicators were not well defined.

This was because management did not adhere to the requirements of the FMPPI due to a lack of proper systems and processes

Reliability of reported performance information

29. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.



Development objectives X: Provision and monitoring of municipal projects

Usefulness of reported performance information

30. I did not raise any material findings on the usefulness of the reported performance information for Development objective X: Provision and monitoring of municipal projects.

Reliability of reported performance information

31. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

Development objectives X: Provision of access to basic refuse removal services

Usefulness of reported performance information

32. The FMPPI requires that indicators be well defined and verifiable and targets be specific, measureable and time bound:

- A total of 40% of the indicators were not well defined.
- A total of 40% of the indicators were not verifiable.

This was because management did not adhere to the requirements of the FMPPI due to a lack of proper systems and processes.

Reliability of reported performance information

33. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

Additional matters

34. I draw attention to the following matters:

Achievement of planned targets

35. Refer to the annual performance report on pages XX to XX for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development objectives reported in paragraphs 24 to 33 of this report.

Adjustment of material misstatements

36. We identified material misstatements in the consistency of the annual performance report and the SDBIP/IDP submitted for auditing on the reported performance information of Provision of access to refuse removal, Provision of access to roads, to provide electricity and Provision and monitoring of municipal projects. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information.



Unaudited supplementary information

37. The supplementary information set out on pages XX to XX does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report thereon.

Compliance with legislation

38. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

39. The performance management system and related controls were not maintained as it did not describe and represent the processes of performance review, reporting and improvement and how it is conducted, organised and managed, as required by sections 38 of the MSA and regulation 7 of the municipal planning and performance management regulations (MPPMR).

Annual report and financial statements

40. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, revenue and disclosure items identified by the auditors in the submitted financial statement were subsequently corrected and the supporting records were provided subsequently, resulting in the financial statements receiving an unqualified audit opinion.

Expenditure management

41. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

42. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Procurement and contract management

43. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by Supply Chain Management (SCM) regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).

44. Awards were made to providers who are in the service of other state institutions or whose directors are in the service of other state institutions, in contravention of MFMA section 112(j) and SCM regulation 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).

45. Invitations for competitive bidding were not always advertised for a required minimum period of days, as required by SCM regulations 22(1) and 22(2).

46. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.

Consequence management

47. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.



48. Council certified irregular expenditure as irrecoverable without having conducted an investigation to determine the recoverability of the expenditure, in contravention of section 32(2)(a)(ii) of the MFMA.
49. Allegations of failure to comply with the supply chain management system laid against officials were not investigated by the accounting officer, as required by SCM regulation 38(1)(b).

Audit committee

50. The audit committee did not advise the council and accounting officer on matters relating to effective governance, performance evaluation as required by section 166(2)(a) of the MFMA.
51. The audit committee did not advise the council on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.
52. The audit committee did not review the annual financial statements to provide the council with an authoritative and credible view of the financial position of the entity, its efficiency and effectiveness and its overall level of compliance with legislation, as required by section 166(2)(b) of the MFMA.

Waste management

53. The municipality operated its waste disposal sites and wastewater treatment facilities without a license in contravention of section 20(b) of the National Environmental Management Waste Act, 2008 (Act No. 59 of 2008) (NEMWA), section 24(2)(a) of the National Environmental Management Act, 1998 (Act No. 107 of 1998) (NEMA) and section 22(1)(b) of the National Water Act, 1998 (Act No. 36 of 1998) (NWA).
54. The municipality's operational activities at its waste disposal sites and wastewater treatment facilities contravened or failed to comply with the requirements of a waste management license, section 67(1)(f) and (h) of the NEMWA and section 151(1)(c) and (i) of the NWA.
55. The municipality's waste management and disposal activities contravened or failed to comply with the requirements of section 28(1) of the NEMA, section 19 of the NWA and sections 16(1)(c) and (d) and 26(1)(b) of the NEMWA.
56. The municipality did not exercise its legislative and executive authority as required by section 11(3)(l) and (m) of the MSA by managing, monitoring and enforcing environmental related bylaws to promote a safe and healthy environment.

Internal control

57. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the findings on the annual performance report and the findings on non-compliance with legislation included in this report.

Leadership

58. Sound integrity and ethical values to promote a culture of honesty, with ethical business practices and good governance, protecting and enhancing the best interests of the entity are not understood and implemented in order to set the standard to ensure compliance with laws and regulations.
59. Adequate oversight responsibility regarding performance reporting and compliance with laws and regulations is not exercised.
60. Effective HR management is not implemented, to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored.
61. Policies and procedures are not adequately implemented to enable and support understanding and execution of internal control objectives, processes, and responsibilities. Furthermore,



policies and procedures are not adequately communicated, to ensure that all officials understand the operating thereof and can implement the procedures as required.

Financial and performance management

62. The municipality did not implement a proper record keeping system to ensure that complete, relevant and accurate information is accessible and available to support performance reporting and compliance with laws and regulations.
63. Management's internal controls and processes over the preparation and presentation of financial statements were not able to ensure that the financials were free from material misstatements. As a result, material corrections had to be made.
64. Management failed to design and implement formal controls to review and monitor compliance with applicable laws and regulations and performance reporting.

Governance

65. Management do not have an adequate risk strategy that addresses performance reporting and non-compliances with laws and regulations.
66. The audit committee does not promote accountability and service delivery through evaluating and monitoring responses to risks and providing oversight over the effectiveness of the internal control environment including financial and performance reporting and compliance with laws and regulations.

OTHER REPORTS

Investigations

67. An independent consulting firm is performing a forensic investigation at the request of the municipality, covering the period 1 October – 30 November 2014. The investigation was initiated due to a system crash and allegations of unauthorised access of IT Systems. The outcome of the investigation is expected during December 2014.

Auditor General

Potchefstroom

30 November 2014



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence

